

RD AN No. 3515 (1930-C)  
February 4, 2000

TO: State Directors  
Rural Development

ATTENTION: Multi-Family Program Managers/Coordinators and  
Rural Development Managers

FROM: James C. Kearney (Signed by James C. Kearney)  
Administrator  
Rural Housing Service

SUBJECT: Allowable Administrative Expenses

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to clarify what constitutes an allowable project administrative expense.

COMPARISON WITH PREVIOUS AN:

No previous AN has been issued on this subject.

IMPLEMENTATION RESPONSIBILITIES:

RD Instruction 1930-C, Exhibit B, (V)(E)(4) discusses acceptable and unacceptable project administrative expenses.

**Acceptable Administrative Expenses:**

Those administrative expenses necessary to successfully carry out project operations may be approved provided such expenses do not duplicate any such expenses which may be included in the management fee as specified in the approved management agreement. The instructions that accompany Form RD 1930-7, "Multiple Family Housing Project Budget," provide further guidance on acceptable project administrative expenses. Preparation of an IRS required report for the project, if required (e.g., Schedule K-1 (IRS Form 1065, 'Partner's Share of Income, Credits, Deductions, etc.,' is an acceptable project expense.)"

EXPIRATION DATE: December 31, 2000

FILING INSTRUCTIONS:  
Preceding RD  
Instruction 1930-C

The instructions that accompany Form RD 1930-7 define what is to be reported on Part II- Operating and Maintenance Expense Schedule, lines 1 - 41. Administrative expenses are reported on lines 19 - 33. Page 10 of the instructions that accompany Form RD 1930-7, "Notes for Administrative Expenses," paragraph (2) states, "Expenses below reflect project expenses only. Expenses that a management firm incur are included in the MANAGEMENT FEE, which is defined in the management agreement according to the management plan."

The management agreement details the specific services that the management agent will perform. According to the sample management agreement in RD Instruction 1930-C, Exhibit B-3, an "Agent" is defined as, "... the person or business entity, including employees at the Agent's office and project site, engaged in the task of providing management of a Rural Development financed MFH project in contractual arrangement with the owner." The management agreement is a contractual arrangement with the owner. Considering the definition of "Agent," project site employees are considered an "Agent." The management agent determines what specific services will be performed at the project site and what specific services will be performed in the agent's office or other locations located off the project site. The costs incurred by the Agent for performing the specified services listed in the management agreement will be allocated to the owner and management agent as outlined in the management agreement, management plan, and approved project budget.

When reviewing the sample management agreement, the following expenses are allocated as follows:

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| 1. Fidelity Coverage (Agent)             | The Agent agrees to furnish at own expense.  |
| 2. Enforcement of Leases (Project)       | Attorney's fees and other necessary costs incurred in connection with such actions.                                  |
| 3. Insurance (Project)                   | Agent will pay premiums out of the general operating account.  |
| 4. Taxes, Fees and Assessments (Project) | Provide for payment from project funds   |
| 5. Employees or Services (Project)       | Persons who perform duties and responsibilities at the project site will be paid as a direct expense to the project. |
| 6. Agent's Compensation (Project)        | Management fee is to be paid from the general operating account.   |

The above expenses are the only expenses that are detailed in the management agreement that clearly define Agent's cost versus Project's cost. Agency regulations require that the costs incurred by the Agent for performing the specified services shall be allocated to the owner and Agent as outline in the management agreement, management plan, and approved budget. The standard management agreement does not clearly detail cost allocations and should be amended by the Agent and owner and reviewed by Rural Development.

Although State Administrative Notices define certain expenses that accrue to the management agent and to the project, these expenses must also be included in the management agreement or as an addendum to the management agreement. Because the management agreement is a contract between the management agent and the borrower, the management agreement is the prevailing document that determines what is an allowable project expense. **THE APPROVAL OF BUDGET EXPENSES MUST BE CONSISTENT WITH THE CURRENT MANAGEMENT AGREEMENT. IF AN INCREASED MANAGEMENT FEE IS APPROVED, THE BUDGET MUST BE REVISED AND SUBMITTED BY THE AGENT AND OWNER, AND APPROVED BY AGENCY SERVICING OFFICIALS TO REFLECT THE APPROVED INCREASE.**

Considering the sample management agreement and the administrative expenses line items (lines 19 - 33) listed on Form RD 1930-7, the following will detail allowable administrative expenses:

- Line 19 - Site Management Payroll
- Line 29 - Health Insurance and Other Employee Benefits
- Line 30- Payroll Taxes
- Line 31- Workman's Compensation

According to the sample management agreement, Exhibit B-3, page 8, paragraph (M) "the Agent will employ persons or services, (or will manage persons or services employed by the Owner) to perform duties and responsibilities at the project site as described in the management plan. Compensation of such persons or services will be paid as a direct expense to the project as specified in the management plan and this agreement."

Budget lines 19, 29, 30 and 31, on Form RD 1930-7, are considered allowable administrative expenses as long as the duties and responsibilities are performed at the project site. The duties and responsibilities must be duties and responsibilities that are typically performed at the project site. For example, bookkeeping functions such as posting of accounts are performed at the management agent's office. This function would be part of the management fee.

There are three exceptions to this requirement:

1. On-site employees' travel expenses for obtaining project supplies, performing banking and postal responsibilities. The management agreement should specify that travel expenses for performing these duties are chargeable to the project as a project administrative expense, and define what are considered travel expenses. The cost of this travel should be charged to the appropriate line item. For example, the resident manager purchases \$50 of office supplies and traveled 20 miles at .31 cents a mile, the total cost of supplies equals \$56.20. Line 26, "Office Supplies", listed on Form RD 1930-7, would be \$56.20. This AN does not require that a project employee be paid .31 cents a mile, however the amount of mileage reimbursement should not exceed the current U.S. Government standards.
2. The sharing of project personnel with other projects; for example, a resident manager that manages two projects. If certain duties and responsibilities are performed off-site at another project site, the management agreement should detail what expenses will be allocated to each individual project and how each expense is prorated. Expenses should be prorated per unit.
3. In some cases, projects cannot afford a resident manager and the management agent performs certain resident manager's responsibilities and the Servicing Officials have approved this arrangement. The management agreement must specify what expenses will be charged to the project as administrative expenses, even though the duties and responsibilities are performed at the management agent's office. PLEASE NOTE: IF THE MANAGEMENT AGENT DETERMINES THAT CERTAIN RESPONSIBILITIES ARE TO BE PERFORMED AT THE MANAGEMENT AGENT'S OFFICE, EVEN THOUGH TYPICALLY PERFORMED AT THE PROJECT SITE, THE COST OF PERFORMING THESE RESPONSIBILITIES IS PART OF THE MANAGEMENT AGENT FEE. TO BE CHARGEABLE TO PROJECT OPERATIONS, THE MANAGEMENT AGENT MUST OBTAIN PRIOR APPROVAL FROM AGENCY SERVICING OFFICIALS. THE AGENCY SERVICING OFFICIAL WILL DETERMINE IF THIS EXPENSE IS CONSISTENT WITH ITS STATE POLICY. THE MANAGEMENT AGREEMENT MUST BE AMENDED AND APPROVED FOR THE EXPENSE TO BE PAID.

Any other payments or gifts to an on-site employee from project accounts, such as bonuses or Christmas gifts, must be covered in the management agreement. THE AGENCY SERVICING OFFICIAL MUST DETERMINE IF THIS EXPENSE IS CONSIDERED AN ALLOWABLE PROJECT EXPENSE.

Budget line 20, "Management Fee," on Form RD 1930-7, is an allowable administrative expense as long as it does not exceed the amount approved in the management agreement. The management agent will be compensated for its services for providing management, described under the management agreement, and the Owner's management plan, by monthly fees, to be paid from the general operating account.

Budget line 21, "Project Auditing Expense," line 24, "Advertising," line 25, "Telephone and Answering Service," line 26, "Office Supplies," and line 27, "Office Furniture and Equipment," listed on Form RD 1930-7, are allowable administrative expenses. Although the management agreement does not clearly define these expenses accruing to the project, the sample management agreement does state that the cost of performing duties and responsibilities for on-site employees are project expenses. A resident manager needs office supplies, a telephone and office furniture and equipment to perform certain duties and responsibilities. Office supplies such as postage, copies, and forms, must be used at the project site. Office supplies used by the management agent in performing their duties and responsibilities at the agent's office accrues to the management fee. Telephone expenses must be incurred at the project site, collect calls to the project from the management agent's office staff are not an allowable administrative expense, nor is the use of calling cards by management agent's office staff. Because of the location of the management agent's office (e.g., management agent office is located in Washington State, the property is located in Idaho) the management agent may request approval to provide a toll-free line for tenants' and applicants' use and charge the costs to project operations. Agency regulations require that all funds disbursed out of the project's general operating account must be for actual, reasonable and necessary expenses. The borrower or management agent must provide evidence that the payment of this proposed expense meets the requirement of being for actual, reasonable and necessary expenses. The Agency Servicing Official will review the request and make a determination if this type of administrative cost meets Agency requirements. If such expense is approved, the cost of project expenses must be detailed in the management agreement and prorated per units among the projects that share costs of this expense.

Project Auditing Expense is an allowable administrative expense as long as the audit is a requirement of Agency regulations or required by an Agency Servicing Official. Auditing expenses incurred because of the requirements of the limited partnership agreement will only be considered a project expense if this requirement is consistent with Agency requirements.

Advertising expenses are considered as an allowable administrative expense. If advertising responsibilities are completed at the management agent's office, only the cost of running ads and flyers are considered a project expense. Any maintenance of records regarding this responsibility advertising to the management fee. If advertisement responsibilities are completed at the project site, all reasonable cost incurred for these responsibilities will accrue to the project. (The responsibilities must be performed by an on-site employee to be 100 percent chargeable to project operations).

Budget line 23, "Legal Expenses" on Form RD 1930-7, is considered an allowable administrative expense. This is an expense for legal services for project operations. This line item deals mainly with enforcement of leases. Attorney's fees and other necessary costs incurred in connection with enforcement

of leases will be paid out of the general operating account as project expenses within the itemized limit of the project budget. IF THE EXPENSE INCURRED EXCEEDS THE ITEMIZED LIMIT OF THE PROJECT BUDGET, PRIOR APPROVAL FROM AN AGENCY SERVICING OFFICIAL IS NEEDED BEFORE PAYMENT IS MADE FROM THE GENERAL OPERATING ACCOUNT. ANY PROPOSED LEGAL FEES THAT DO NOT DEAL WITH ENFORCEMENT OF LEASES WILL NOT BE CONSIDERED AN ALLOWABLE PROJECT EXPENSE, UNLESS PRIOR APPROVAL FROM AGENCY SERVICING OFFICIALS HAS BEEN OBTAINED.

Budget line 32, "Other Administrative Expenses", listed on Form RD 1930-7, is considered an allowable administrative expense to the extent that Agency regulations clearly allow such an expense. For example, in some instances cost of credit reports are reported under line 32, "Other Administrative Expenses." This is an allowable project expense as long as the management plan states that part of the management agent's screening criteria is obtaining credit reports in making the determination of eligibility of occupancy.

It is the borrower's or management agent's responsibility to detail what costs are reported under line 32. All project administrative expenditures must be evaluated by the Agency as being reasonable for the services provided, including the reasonableness of the expenditures for management agent services. According to the instructions attached to the budget form, the borrower or management agent is to indicate what costs are reported on line 32, this includes detailing what expenses are reported on line 32. Without this additional information, the Agency Servicing Official cannot make a determination if the cost is for actual, reasonable, and necessary expenses.

In several instances, it was determined that expenses for picnics, gifts, donations, etc., are charged to line 32, "Other Administrative Expenses." Administration expenses that cannot be properly reported (TO BE PROPERLY REPORTED, THE EXPENSE MUST BE CONSISTENT WITH THE INSTRUCTIONS ATTACHED TO THE BUDGET FORM WHICH DETAILS WHAT IS REPORTABLE ON EACH BUDGET LINE ITEM) on lines 20 - 31 and are reported under "Other Administrative Expenses" are considered administrative expenses that fall outside Agency established guidelines.

When administrative expenses fall outside Agency established guidelines, prior approval is necessary before incurring that expense. Because of the additional time required by both the borrower and Agency personnel to meet this requirement, the Agency will allow up to \$15 per unit per year for "Other Administrative Expenses" to be reported under line 32 without the Agency's prior approval. The Agency will consider picnics, gifts to project site employees and/or tenants for special occasions, donations to charities or local community charitable causes, small appliances and kitchen utensils for community rooms, and grills for picnics as an allowable "Other Administrative Expenses" not to exceed the total cost of items purchased, or \$15 per unit per year. Any "Other Administrative Expenses" not detailed in this AN must have prior approval from Agency Servicing Officials before incurring. This \$15 per unit per year does not include the cost of credit reports or energy audits that may be reported on line 32. If an identity of interest payment is made through this process, this identity of interest must be disclosed as required by Agency regulations prior to payment. Upon submittal of any budget for approval, line 32 must be detailed to inform the Agency Servicing Official what "Other Administrative Expenses" are being charged to project operations. If a cash flow problem exists, the borrower/management agent must obtain prior approval of Agency Servicing Officials before incurring a \$15 per unit per year "Other Administrative Expenses."

If you have any questions, please contact Terry Bishop in the Multi-Family Housing Portfolio Management Division at (202) 690-0759.4